Microfinance, Poverty and Social Performance: *Overview*

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1. Introduction

The nature and extent of the impact of microfinance, particularly on poverty incidence, and the nature of the economic and social outcomes that microfinance is expected to have – particularly the impact on poverty – continues to promote lively debate. There is evidence that microfinance can have a positive impact on the economic and social situation of clients, their households and their businesses, as well as wider social and economic impacts, including changing social relationships and labour market effects (Morduch and Haley 2002).[2] These impacts can in turn affect the overall incidence of poverty, whether defined in narrow income terms or more broadly. Hence, one important aspect of debate is the potential contribution of microfinance to the Millennium Development Goals (Littlefield *et al.* 2003). However, the potential impact of microfinance may go beyond these definitions of poverty. For example, impacts on gender inequality may relate to women above as well as below the poverty line (Jackson 1996). While working with relatively poor people, many microfinance organisations (MFOs)[3] have explicit social goals that are not solely defined in terms of poverty. For this reason, the term "social performance" is used to cover the broad concern with social and economic impact (including poverty), which together with "financial performance" constitutes an MFO's "double bottom line".

Systems for routinely measuring social performance of microfinance are at an early stage of development. Until recently, most formal social performance measurement took the form of ad hoc impact assessment studies with a 'proving' objective (Hulme 2000), in other words, to justify donor funding. These studies were generally undertaken by external consultants, and often relied on formal sample surveys of clients and control groups. In recent years there has been a move away from this type of "donor-led" impact assessment towards work that is more closely aligned to the operational needs of MFOs. This orientation is intended to enable MFOs themselves to better understand who they are reaching, how they use the services available, and what change is occurring as a result. The intention is to ensure that findings about impact are useful in further developing the products and services on offer and hence improving both practice and future impact (Simanowitz 2001).

The articles presented in this *Bulletin* reflect the ideas and practice of the *Imp-Act* action-research programme (see Preface for details). This work is premised by the view that it is necessary to judge the performance of MFOs in both social and financial terms. This emphasis was missing from the mainstream of the microfinance industry in the 1990s when financial sustainability became the key goal (Otero and Rhyne 1994). However, many MFOs have retained their concern to demonstrate their social performance. While the use of public funds for microfinance is one reason for donors to require impact assessment work, MFOs that are financially sustainable and do not require donor subsidies may have their own social mission against which they wish to measure their progress.

The *Imp-Act* programme developed from a concern that MFOs wanted to conduct impact assessment work to understand and report on the benefits and costs that their services provided to their clients. It has therefore built on prior work in the industry that emphasises the need for more timely and cost-effective data. Examples include development of "middle-range" impact assessment studies which could be carried out by MFOs themselves (Barnes and Sebstad 2000), as well as work on how to develop more client-focused products and services through "listening to clients" and through market research (Wright 1999; Cohen 2002). The work of *Imp-Act* has sought to further develop this agenda, with an emphasis on the development of impact assessment systems. This focus on systems recognises that MFOs have multiple stakeholders: boards, managers and staff, clients, investors – whose needs for information about social performance vary. It is then necessary to accommodate these needs by information collection, analysis and feedback mechanisms that are ongoing and dynamic rather than one-off events. In moving from a "proving" to an "improving" agenda for impact assessment, the programme seeks to combine a concern with credible analysis of information about the impact of microfinance on poor people's livelihoods, with the need to ensure that this information enables MFOs to improve their services, and hence improve their performance in terms of both their financial and social bottom lines.

This article provides a broad overview of all the articles in the *Bulletin*. The articles themselves are arranged into three groups under the broad headings of "poverty", "institutionalisation" and "wider impacts". Rather than following this structure, the sections in this overview are based upon a distinction between the three components of a performance management system. Section Two reviews what the articles have to say about broad strategy and performance *goals*. Section Three considers performance *assessment*, and Section Four considers performance *management*.

This broad distinction is explored in more depth in Copestake (article 5, this *Bulletin*). He argues that a culture of social performance management within MFOs can best be brought about by challenging all MFOs to develop answers to four questions:

- What are your social performance goals?
- How do you monitor the status of your clients?
- How do you assess the value added or impact of the services that you provide to clients who remain, and who leave?
- How do you audit and seek to improve the quality of systems for monitoring client status and impact?

In this overview, Section 2 addresses the first question, Section 3 addresses the next two, and Section 4 considers the last.

2. Social performance goals

2.1 Setting the context: from supply-led to client-focused microfinance

Kabeer (article 10, this *Bulletin*) discusses the differing rationales for microfinance interventions. These include the provision of financial services to excluded people, a strategy for poverty reduction, and microfinance as 'one aspect of an overall strategy to empower poor and marginalised groups'. The goal of the MFO, and its understanding of the role of financial services, are thus major factors in analysing their social performance.

In the past, commercial banks failed to reach poor clients, as they found it too costly to provide very small loans, or take small amounts of savings from people who were unlikely to be able to generate the income to repay their loans or to provide collateral in the case of default. The 'first microfinance revolution' (Matin *et al*. 1999) demonstrated that poor people can both save and productively use and repay credit, even where it is not lent on the basis of collateral. Methodologies were developed which allowed MFOs to achieve high levels of staff productivity and set repayment rates to make it cost-effective to provide these services. The 1980s and 1990s saw a burgeoning of the microfinance industry, and despite the development of a huge diversity of approaches, the replication of a few tried and tested methodologies throughout the world.

This 'have methodology will travel' (Helms 2003: 3) approach to microfinance has been very successful in terms of establishing a worldwide microfinance industry (Microcredit Summit 2002). However, it is supply-led and does not necessarily provide the services or products that best suit the needs of the poor people it seeks to reach. Recent research has highlighted this as a major problem in microfinance (Cohen 2002). In the context of little competition, MFOs are mostly able to expand and find clients who will accept the short-comings in the service provided in order to access some of the financial services that they need. However, many clients later experience problems that are related to the inappropriateness of the products or, in the face of increasing competition, decide to join another organisation. CARD (article 8, this *Bulletin*), for example, describes a process by which they examined the reasons for client exit, revealing factors relating to client vulnerability and programme design. Increased organisational understanding from this and other impact-related research has assisted CARD in rethinking a number of aspects of its programme, thus increasing its poverty focus and responsiveness to the specific needs of different client groups.

The move towards more "client-led" or "demand-driven" microfinance is part of an increasing commercialisation and professionalisation of the industry. Central to this is the recognition of the importance of understanding the needs of different segments of the market, and providing a greater range of more flexible services. Clients can thus be better served, and the inefficiencies of supply-led microfinance eliminated. More flexible services can, however, be more complex for the MFO to manage, and may therefore create organisational challenges.

2.2 What are the social performance goals?

MFOs need to develop services based on an understanding of the needs of potential clients in the area in which they operate. These include the specific expressed needs, and also those derived from an understanding of the range of direct and indirect, economic and social impacts that microfinance may have. The way in which an MFO analyses poverty, exclusion, vulnerability, inequality, the local economy, financial markets and other aspects that it might wish to have an impact on, leads directly to the strategies and methodologies it will adopt.

Copestake (article 5, this *Bulletin*) provides a useful framework for understanding social performance. This separates poverty impacts – income, non-income and wider – from other direct and wider impacts. As discussed in the introduction, there is a great overlap between social performance and poverty impact, particularly where broad definitions of poverty are used which include, for example, inequality, powerlessness or vulnerability. However, it is important to stress that not all social impacts can be reduced to poverty impacts.

Greeley (article 1, this *Bulletin*) notes the success of microfinance in reducing poverty. Various dimensions of this are discussed in the findings presented in the articles in this *Bulletin*. However. the focus is more on the processes by which impacts are achieved, through direct benefits to individuals, and through wider social mechanisms, and less on describing or debating the magnitude and nature of impact of microfinance on poverty.

Early approaches to microfinance were mostly focused on the potential of poor people to invest very small loans in income-generating businesses with a consequent focus on the productive use of credit. Many MFOs therefore imposed conditions relating to previous business experience, the use of the loans, and business skills training to their loans. While microcredit for microenterprise development has proved to be very successful with thousands of MFOs lending to millions of microentrepreneurs and substantial income benefits as a result (Morduch and Haley 2002), it is now clear that microfinance has a much greater role than just providing credit for microenterprise development.

Recent analysis points to the importance of financial services in assisting poor people to manage their livelihoods, and in particular reducing their risk and vulnerability (Sebstad and Cohen 2000). Rutherford (2000) highlights the need for 'lump sums' of money (i.e. larger amounts than are normally available on a day-to-day basis) for investment in economic and social opportunities, consumption, life cycle needs, and to cope with crises and emergencies. Poor people can obtain these lump sums through putting aside smaller sums of money when they become available – either as savings, as repayments for credit, or as investment in other financial services such as insurance. Credit for enterprise development continues to play an important role, but it is one of a number of dimensions to microfinance that supports poor people's livelihoods.

Noponen and Dash (articles 6 and 13, this *Bulletin*) discuss the use of microfinance as one important component of livelihood support programmes. They highlight the way in which the financial services assist poor people in managing the predictable and unpredictable needs for money, and thereby reduce their vulnerability, increase their ability to take hold of opportunities, and contribute to a sustainable movement out of poverty. In a similar vein, BRAC has considerable evidence of movement in and out of poverty and Halder (article 4, this *Bulletin*) therefore cautions the view that access to credit leads to sustained income growth and underlines the importance of BRAC's programme in reducing the vulnerability of clients to shocks which can precipitate a downward slide.

Kabeer (article 10, this *Bulletin*) discusses the social impacts that develop through the non-economic aspects of microfinance – 'a social understanding of poverty takes account of… other "deficits" that matter to people, sometimes more than money'. Impacts take place in different areas. That of 'family and kinship' is the area most commonly examined in impact assessment. Beyond the household are 'community and civil society', 'markets and economy' and 'state and polity'. While recognising that these domains intersect and overlap, Kabeer focuses particularly on what she calls 'wider social' impacts which she defines as those that operate in 'domains of society beyond the household' or which bring the private into the public domain.

Examples of such 'wider social' impacts are given by Noponen and Mosley (articles 12 and 14, this *Bulletin*). Noponen describes reductions in violence against women, as PRADAN (Professional Assistance for Development Action) members record incidents of violence against them in their diaries. She suggests that it is the public nature of this record that leads to the change in behaviour. Mosley, on the other hand, presents evidence of the stabilising effect that micro-insurance services can have for MFO clients in Bangladesh and Uganda. The reduction of risk and vulnerability at an individual level creates wider impacts on the stability of income for the wider community. The resulting improvements in income security for the community as a whole then provide a basis for the strengthening of personal relationships and social capital.

Kabeer also suggests that the use of group-based methodologies in the delivery of microfinance has the potential to increase clients' knowledge of and participation in the wider world. However, while the use of groups has the potential to build social capital, develop skills and empower clients, the way they are used varies considerably between MFOs. Some use them solely as a means for creating peer group pressure while others use them more deliberately as a vehicle for the empowerment and development of clients. Noponen and Dash (articles 12 and 13, this *Bulletin*), discuss the role of Self-Help Groups (SHGs) in the Indian context, particularly in terms of their ability to take collective action on issues beyond the narrow confines of financial services in the wider community. These groups of poor women develop in automonous, self-sustaining units which facilitate savings and credit, and are also a vehicle for the empowerment of the poor, both on an individual and community level. Noponen presents a framework for understanding potentially reinforcing processes in household well-being, economic empowerment, and social and political empowerment. This highlights the potential for SHGs to create benefits on an individual and wider level, in terms of a number of dimensions of income poverty, and social exclusion.

The contribution of Olejarova *et al*. (article 11, this *Bulletin*) further highlights the importance of wider social dimensions of impact. For the 'new poor' in context of high unemployment in the former communist states of Eastern Europe, vulnerability is created by the lack of the right social connections, particularly as sources of social security. Despite good education and a high level of assets, many people lack the resources to maintain their social connections. In this context microfinance groups have the potential to build social capital and Olejarova concludes that microfinance has an important role in developing and strengthening informal social connections. However, structural inequalities in society remain, and there is no evidence of increased participation in formal associations where most of the power within society lies.

2.3 Developing strategies for achieving social performance outcomes

It is important to recognise that, despite strong evidence of the potential of microfinance to impact on poverty and other social dimensions, provision of financial services in their own right will not necessarily lead to poverty reduction. A first step to ensuring effectiveness in their social goals is for MFOs to develop an understanding of the status of their existing or potential clients. This allows for appropriate design of the products, services and delivery mechanisms of the MFO. The nature of this understanding, and therefore the objectives set by the MFO, will lead to different approaches and different criteria by which an MFO can be judged. For example, an MFO that seeks to have an impact on poverty, and understands this in purely economic terms, is likely to adopt different strategies to one that appreciates the non-economic aspects of poverty. The strategy adopted by an MFO will also be determined by feasibility, and in particular the need to balance social and financial performance.

A number of articles in this *Bulletin* demonstrate how MFOs have taken specific steps to collect data which enabled them to better understand and analyse the context in which they were working, and thereby improve their ability to design appropriate services. Halder (article 4, this *Bulletin*) outlines how BRAC in Bangladesh addresses the needs of people at different levels of poverty. For BRAC, there is a continuous process of assessment and reflection to design appropriate services for those people who may be excluded or who do not benefit from their services.

Another example is the Centre for Youth and Social Development (CYSD) in India, which chooses to work with the most remote and marginalised "tribal" people in its region. Their strategy is intensive, and is made at the expense of organisational self-sufficiency for CYSD. Dash (article 13, this *Bulletin*) makes a compelling argument for a more comprehensive approach when working with these communities for whom poverty is endemic and extremely complex, and is characterised in terms of 'geographical seclusion, social exclusion, economic exploitation, and political disfranchisement'. Dash argues that in this context minimalist microfinance will not succeed in reducing poverty. A focus on credit for microenterprise development is particularly problematic due to the poorly developed economy and low returns on investment. CYSD uses an approach to poverty reduction that combines education, health, a range of training programmes, development of natural resources, access to basic services, inputs and services to enhance food security, community group building, and capacity enhancement for improved governance.

A balance needs to be struck between the additional costs and complexity of a more comprehensive intervention and the additional benefits achieved in terms of poverty alleviation. Only a small number of MFOs are able to tackle poverty in an holistic way, particularly if they seek to achieve financial self-sufficiency and provide outreach to large numbers of people. Greeley (article 1, this *Bulletin*) discusses the nature of trade-offs between these often competing objectives. He suggests that organisational commitment to a poverty-focus can lower the costs of targeting poorer clients. Kline (article 3, this *Bulletin*), for example, describes how

Prizma, a financially self-sufficient organisation in Bosnia and Herzegovina, has successfully combined these dual objectives and has succeeded in achieving financial self-sufficiency, whilst retaining a commitment to achieving significant impact and outreach to the very poor.

CARD in the Philippines, however (article 8, this *Bulletin*), despite a mission to relieve poverty, has found that providing credit for enterprise development in the poorer and more remote rural areas is problematic both for the organisation and its clients. As well as the additional costs of working in remote areas with low population densities, these regions have a low level of economic activity, and therefore lower potential returns on the investment of credit. CARD is currently using its improved understanding of client needs and context to develop improved strategies for combining its social and financial objectives.

Some MFOs have sought to achieve a poverty focus by deliberately targeting their services towards the poor. They use screening or targeting tools to determine whether people are eligible to join the programme and typically exclude those with income or assets over a certain level. On the other hand, even where MFOs do not adopt these strategies, people may be excluded as a result of either their own lack of self-esteem, or of the attitudes and policies of the MFO – whether deliberate or inadvertent. The articles by Roper and Kline provide two examples of poverty targeting strategies used by *Imp-Act* partners. The Small Enterprise Foundation (SEF) in South Africa (Roper, article 7, this *Bulletin*) effectively achieves significant depth of poverty outreach using a combination of a targeting tool plus active motivation of poor and very poor people to join the programme. Kline, by contrast, explains how Prizma achieves similar success in poverty outreach without active targeting. It puts considerable effort into analysing the dynamics of poverty in its context, has identified the ways in which exclusion operates, and is taking steps to re-evaluate and re-engineer aspects of its operations and performance management system to enable these people to join. This has included the promotion of a culture of poverty focus, a strategy to manage for social performance, and a system to measure or monitor impact or social performance.

3. Measuring social performance

The previous section has underlined the importance of understanding the needs of clients, the context in which an MFO is working and its mission, for determining its social performance goals and the strategies adopted to reach them. This section looks at how social performance can be measured, through internal monitoring and assessment systems, and by external stakeholders. A key objective of the *Imp-Act* programme is to demonstrate that MFOs can cost-effectively collect information from their clients to improve social and financial performance.

As in many fields of development, the foundation for adequate evaluation and impact assessment is a strong monitoring system. In the case of microfinance this entails routinely measuring, or tracking, the changing status of new, existing and exiting clients. Status may be defined in relation to one or a battery of social and economic indicators. Although changes in the status of clients cannot automatically be attributed to the services provided by the MFO, this data can enable experienced managers to make informed judgements about impact by triangulating it with data from other sources including day-to-day operational indicators such as exit rates, loan sizes and so on. However, for those without such reference points, monitoring or tracking of client status must be supplemented with more formal impact assessment.

MFOs commonly collect data on new clients and sometimes track socio-economic and demographic data on an ongoing basis. This may include sex, age, marital status, employment, number of children, education level, business type, income, location and so on. However, the most debated social performance status measure is poverty. Greeley (article 1, this *Bulletin*) highlights that, despite the concern for poverty reduction, there is little transparency in the microfinance industry in terms of poverty outreach and impact. Poverty assessment can also either take place as a one-off activity giving a detailed profile at a particular moment in time, or continuously as part of the recruitment process of new clients. Van de Ruit and May (article 2, this *Bulletin*) discuss two of these assessment methods – the survey-based Consultative Group to Assist the Poorest (CGAP) Poverty Assessment Tool, and participatory wealth ranking (PWR). They compare data generated by a simple (useable by practitioners) poverty assessment mechanism with national and international poverty data. They stress the weakness of income-based measures of poverty such as the '$1 a day' measure, and highlight the value of using broader definitions, including those such a PWR. Roper (article 7, this *Bulletin*) further discusses the use of PWR as a poverty-targeting tool.

A range of methods can be used for tracking client status on a routine basis. Prizma (Kline, article 3, this *Bulletin*) has developed a poverty scorecard system to assess and track changes in poverty status, including a number of robust, non-economic proxy indicators for poverty. SEF's impact-monitoring system (Roper, article 7, this *Bulletin*) tracks social and poverty-related indicators from all clients on each loan cycle. These are entered into a computerised management information system and allow for specific patterns of impact to be analysed. PRADAN (Noponen, article 6, this *Bulletin*) uses a participatory client diary system, whereby members track and analyse changes in many aspects of their lives in personal, pictorial diaries. These diaries are summarised and discussed at group level, and can also be used to provide organisational level information.

Each system is adapted to the specific context of the organisation, and their information needs. Prizma collects information to assist in understanding its impact, and to demonstrate to an external audience 'the extent to which it is (a) reaching who it seeks (and claims) to be reaching and (b) fulfilling its social mission'. SEF uses its monitoring system as a learning tool for field staff and, to a limited extent, clients, allowing staff to identify more vulnerable clients and target support. Data processed at head office is also regularly reported to SEF's Board and other external stakeholders. By contrast, PRADAN's focus is primarily to use the data to support the development of the clients and their groups.

As the discussion of the previous section highlighted, MFOs can have significant wider impacts beyond the household, by which their social performance can be judged, but few of them either identify or seek to systematically collect data on these. For example, impact through labour markets or employment may affect the poverty of non-microfinance clients, even though an MFO is not directly working with poor clients. Whilst the issue of attributing impacts to the actions of an MFO is difficult in any impact assessment, this becomes even more problematic when assessing wider impacts, for example the relationship between improved education and inter-generational poverty. Kabeer (article 10, this *Bulletin*) discusses available methodologies (use of secondary data, triangulation of data from different sources and an iterative process) and stresses the need for assessments to be based on a theoretical model of social change which outlines the likely relationships between impacts and their causes.

4. Performance management

The institutionalisation of social performance into MFO practice involves both the development and use of internal information systems as discussed above and strategies for ensuring that information is credible when reported to external audiences. Copestake (article 5, this *Bulletin*) discusses two approaches to the reporting of social performance data. First, he considers the role of standard data reporting requirements that can be compared between organisations. An example would be MFOs reporting on poverty outreach in ways that allow comparison against international poverty lines. However, Copestake argues that this would be too rigid for the diverse range of needs of MFOs, and is likely to push MFOs towards providing data for external stakeholders rather than their own needs. An alternative approach would be a system of auditing in which MFOs develop their own systems of social performance measurement and management and then external auditors verify the system and the data it produces against agreed social performance benchmarks and methodologies.

The second approach remains underdeveloped. However, considerable progress is already being made to ensure that impact assessment generates information that is more responsive to management needs. While past discussions of impact assessment tended to focus on the tools and methodologies for information *collection*, the *Imp-Act* programme has emphasised the organisational dynamics influencing whether or how information is *used*. MFOs are likely to be responsive to information generated, and thus enhance their social performance, if their management systems and services are developed with this goal in mind.

A key problem with past impact assessment studies has been the failure to translate useful findings into operational changes and improved practice. There has been a major gap in the use of information, which is not necessarily solved by more practitioner-orientated impact assessment. The 'feedback loop' (McCord 2002) is a simple way of leading organisations through a logical process from information collection to analysis, decision-making and implementation. Cohen and Wright (article 9, this *Bulletin*) use this approach to examine the way three Latin American MFOs have used information they have collected to improve their practice.

Where organisational learning systems are established, and the feedback loop is completed, there is a great potential for MFOs to use social performance data to assist with the management of their organisations. In combining poverty outreach and financial self-sufficiency goals difficult decisions often need to be made. However, if social performance data is not available, decisions are more likely to be made on financial data alone, and as a result these goals are likely to lose out. Roper (article 7, this *Bulletin*) describes how SEF has been able to balance these objectives, using its impact-monitoring data as part of its strategic management. SEF experienced a serious decline in its financial performance but was able to combine the use of its financial and impact-monitoring data to pinpoint the root of the problem and take necessary remedial action, so balancing the need for improved financial performance with social performance goals.

SEF and Prizma have both achieved depth of poverty outreach and impact and the articles on them reflect on the importance of organisational culture in achieving this. The culture must be one in which learning is desired by the organisation, encouraged among staff and led by senior staff. It must involve effective communication at and between all levels of the organisation, starting with the clear communication of the MFO's mission and objectives to staff and clients. It must also be a culture that rewards achievement of the MFO's social goals through well-designed incentive systems.

5. Conclusions

The microfinance industry is moving on from a predominant emphasis on financial sustainability to a renewed concern with social performance and the "double bottom line". At the same time, MFOs are recognising the need to collect and analyse this data themselves in order to respond to the needs of their clients and improve their products and services. The articles in this *Bulletin* report progress in both conceptualising social performance goals and finding ways to monitor and assess change.

Key to the achievement of improved social performance are the generation of information that is credible, useful, appropriate organisational systems, and a commitment to learn and use the information generated. Client-led microfinance must be responsive, not only to the needs of clients evident from market research, but to a deeper understanding of the underlying social, economic and political processes in which an MFO operates.

Finally, some form of standards or benchmarks will be useful, both to MFOs themselves that have a commitment to their social objectives, and to the industry as a whole in its search to ensure high standards of operation and secure subsidised funds. On this issue there is still further work to be done.

Notes

1. Substantial contributions to the re-writing of an original draft have been made by Susan Johnson and James Copestake.
2. Morduch and Haley provide a comprehensive literature review on the poverty impacts of microfinance.
3. "Organisation" is used here in preference to "institution" to acknowledge the more precise social science definition of an institution as a "norm of behaviour" whilst an organisation is a legal entity.

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